

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 16947
[Redacted]	)	
Petitioner.	)	DECISION
_____	)	
	)	

On August 30, 2002, the Income Tax Audit Division of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (“taxpayer”) asserting an Idaho income tax liability in the amount of \$48,632 for the 1995 through 1997 taxable years. On October 16, 2002, the taxpayer filed a timely appeal and petition for redetermination. An informal conference was requested by the taxpayer and was held on March 28, 2003. Subsequent to that informal conference the taxpayer and the Commission agreed to extend the time in which the Commission was required to issue this decision by an additional six months; to March 22, 2004. The Tax Commission, having reviewed the file, hereby issues its decision upholding the August 30, 2002 Notice of Deficiency Determination.

**FACTS AND PROCEDURAL HISTORY**

[Redacted] is a Delaware corporation that is primarily engaged in the manufacturing and sale of candy bars and similar confectionary products. The company is the parent of a group of corporations that includes [Redacted], as well as a number of foreign affiliates. During the years at issue in this protest, [Redacted] was the [Redacted] maker in the United States. [Redacted] is headquartered in [Redacted], Virginia. It is a privately owned corporation and, therefore, does not publish annual reports to its shareholders or otherwise disseminate financial information to the public.

Neither [Redacted] nor any of its affiliated subsidiaries filed Idaho corporate income tax returns for any of the 1995 through 1997 taxable years. In April, 1999, the Idaho State Tax Commission authorized the Multistate Tax Commission (MTC) to conduct a non-filer audit of [Redacted] and subsidiaries. Based on that audit, the MTC audit staff found that [Redacted] and all of its more than 50% owned subsidiaries were engaged in a single unitary business. The audit staff also found that [Redacted] and two of its subsidiaries, [Redacted] had sufficient nexus with Idaho to be required to file Idaho corporate income tax returns. The MTC audit staff provided the Tax Commission with a detailed audit report that included a proposed Idaho corporate income tax calculation that was computed on a worldwide combined reporting basis. The Idaho State Tax Commission's audit staff, after reviewing the MTC audit narrative and supporting documents, accepted the recommendations of the MTC audit staff subject only to a modification relating to the amount of FSC income to be included in the combined net apportionable income. Interest and the 25% non-filer penalty were added, and the Notice of Deficiency Determination that is the subject matter of this protest was then issued.

### **ISSUES PROTESTED**

Three issues have been raised in this administrative protest. Those issues are:

1. Whether [Redacted] engaged in activity within Idaho that exceeds the protection of Public Law 86-272.
2. Whether [Redacted] and its affiliated subsidiaries are engaged in a unitary business.
3. Whether certain "miscellaneous" errors were included in the MTC audit workpapers relating to the calculation of the combined net apportionable income and the calculation of the Idaho apportionment factor.

This Decision will address each of these issues in turn.

## ANALYSIS

### A. The Idaho Activities of [Redacted] and its Two Affiliates Exceed the Protection of Public Law 86-272.

The first issue raised in this protest is whether the Idaho activities of [Redacted] exceed the protection of Public Law 86-272, 15 U.S.C. 381. The MTC audit staff determined that the Idaho activities of each of these three corporations exceeded the Public Law.

Public Law 86-272 was enacted by Congress in 1959 as an express limitation on the ability of the several states to impose an income or franchise tax. The Public Law provides that a nondomiciliary corporation is not subject to the income tax jurisdiction of a foreign state if that corporation's only activity within the foreign state is limited to the solicitation of sales of tangible personal property or activity that is entirely ancillary to the solicitation of sales of tangible personal property. Non-solicitation activity within the foreign state that goes beyond the protection of the Public Law will result in the loss of the tax immunity afforded by the Public Law. Once the immunity is lost, the corporation becomes subject to the income tax jurisdiction of the foreign state for that taxable year. See Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272.<sup>1</sup>

1. [Redacted] According to the MTC audit staff, the Idaho activities of certain "territory sales representatives" employed by [Redacted]. exceed the protection of the Public Law. According to the MTC Audit Report:

[Redacted] has employees called territory sales representatives that have home offices in the following states . . . : [Redacted]. . . . These employees (herein after referred to as [Redacted]representatives) call on their assigned customers which are located in territories that do not correspond

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<sup>1</sup> The Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272 was promulgated by the Multistate Tax Commission and its member states in 1986, and revised in 1993, 1994, and 2001. The revised version of the Statement of Information can be viewed on the MultiState Tax Commission website at <http://www.mtc.gov/news&vws/Regs102000.pdf> (page 130).

to geographical boundaries. They are provided with company automobiles. A copy of the job description is attached as Exhibit N-3. One of the duties listed in the job description is stated as follows: "Conducts periodic warehouse checks to ensure that our products reach operations in a fresh and saleable condition. Removes and issues credit for any unsaleable product." The tax manager [of [Redacted].] was questioned about what this particular activity involved and his explanation was clarified in a written letter dated March 7, 2002. See Exhibit N-1.

The [Redacted] representative inspects the shelves of each retail location on his/her route and meets with the store manager. The [Redacted] representative will remove any product considered unsaleable and may reorganize the display. The [Redacted] representative will also verify any unsaleable product that store personnel have pulled off the shelves as unsaleable. The store is required to complete a Form S507-Credit Requisition. The [Redacted] representative must verify the destruction of the unsaleable merchandise and must sign the Form S507. The [Redacted] representative then sends the Form S507 to the [Redacted], NJ office for processing. The store will not get credit for the unsaleable merchandise without the signature of the [Redacted] representative. Since the store will not get credit for the unsaleable merchandise without the [Redacted] representatives' [sic] signature, the representative is essentially authorizing the credit even though the form must be sent to [Redacted] headquarters.

Audit Report, Exhibit N, p. 1. Thus, the MTC audit staff determined that the periodic stock checks to ensure the freshness and saleability of the company's product, when coupled with the removal of unsaleable product and the authorization of credit, goes beyond the protection of the Public Law. We agree.

The United States Supreme Court, in Wisconsin Department of Revenue v. William Wrigley, Jr. Co., 505 U.S. 214, 112 S.Ct. 2365 (1992), held that the term "solicitation" as used in the Public Law covered three types of activities: (1) express solicitation of orders, (2) implied solicitation of orders, and (3) any activity that is entirely ancillary to express or implied solicitations. Wrigley, 112 S.Ct. at 2453 – 2454 and 2456 - 2457. An activity is entirely ancillary to express or implied solicitations if it serves no legitimate business purpose outside the solicitation of orders. For example, "[p]roviding a car and a stock of free samples to salesmen is

part of the ‘solicitations of orders,’ because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company’s products is not part of the ‘solicitation of orders,’ since there is good reason to get that done whether or not the company has a sales force.” Id. at 2457.

In the present case, the stock checks for the purpose of identifying and removing stale and unsaleable product, and the authorization of credit to be used by the customer to replace the unsaleable merchandise, are not entirely ancillary to the solicitation of orders. There are sound business reasons for [Redacted]. to perform these activities besides the mere solicitation of orders. While these stock check and credit authorization activities “may help to *increase* purchases,” they are “not ancillary to *requesting purchases*, and cannot be converted into ‘solicitation’ by merely being assigned to salesmen.” Id. As a result, the Commission finds that the Idaho activity of the [Redacted] sales representatives during the years at issue in this administrative appeal went beyond the protection of Public Law 86-272. [Redacted] had an Idaho income tax filing requirement during each of the 1995, 1996, and 1997 taxable years.

**2. [Redacted]** Whether or not the activities of [Redacted]. exceed the protection of Public Law 86-272 is a much closer question. This is due to the fact that the taxpayer did not provide the MTC audit staff with much detail regarding the solicitation activities performed by or on behalf of these two affiliate corporations. As explained in the MTC Audit Report:

[Redacted] had claim [sic] protection under P.L. 86-272. . . . When initially questioned about [Redacted] activities, the taxpayer stated that [Redacted] uses Food Brokers. The taxpayer was requested to provide sample copies of the broker contracts used in the audit period. None were ever provided. The payroll apportionment schedules revealed employees in the states of [Redacted] in 1995 and 1996. The explanation of the duties of these employees listed in the 1995 and 1996 apportionment schedules was unclear. A review of the court case *Bodie vs. Mars Incorporation* [U.S. District Court for the Western District of Tennessee, Civil Action No. 87-2795] revealed that broker contracts were used during

the 1980's when the consolidation of food brokers began. Attached are copies of the food broker contracts entered into evidence [in that] court case. The contracts stated that the food broker's [sic] must perform credit checks on the customers of [Redacted] for the audit period. Performing credit checks is an unprotected activity, since P.L. 86-272 lists "investigating credit worthiness" as being unprotected. The conclusion was that food broker contacts [sic] do exist and the taxpayer did not want the contracts examined. . . .

[Redacted] was concluded to have nexus in the state.

Audit Report, Exhibit N, p. 2 – 3. A similar statement is set out in the Audit Report relating to [Redacted]. Id. at p. 3.

Public Law 86-272 does not specifically list "investigating credit worthiness" as being unprotected activity. Thus, the quote set out above is incorrect to the extent that it states that "P.L. 86-272 lists 'investigating credit worthiness' as being unprotected." It appears that the auditor was referring to the "Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272." Part IV.A.3 of that Statement lists "[i]nvestigating credit worthiness" as activity that, if conducted in-state, would exceed the protection of the Public Law.<sup>2</sup> In any event, the gist of the MTC audit findings was that since the taxpayer did not provide any documentation to establish that the food brokers used by [Redacted] were performing only protected activity within this state, the presumption is that those brokers were performing unprotected credit investigations within Idaho.

While the evidence supporting the audit staff's determination is less than stellar, this is due in large part to the taxpayer's unwillingness to be forthcoming with the audit staff regarding the sales and solicitation activities performed by or on behalf of [Redacted]. The MTC audit staff has a right to review relevant books and records of the taxpayer, and the taxpayer has not provided any explanation for why it failed or refused to provide the MTC auditor with the

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<sup>2</sup> See footnote 1.

requested food broker contracts. In addition, the taxpayer has not provided any evidence or argument during this administrative protest to establish that the audit staff's determination was in error. As a result, the Tax Commission finds that during each of the years at issue the Idaho activity of the food brokers acting on behalf of [Redacted] went beyond the protection of Public Law 86-272. As a result, both [Redacted]. had an Idaho income tax filing requirement during each of the 1995, 1996, and 1997 taxable years.

**B. [Redacted] and its More than 50% Owned Subsidiaries are Engaged in a Single Unitary Business.**

The taxpayer next argues that “[e]ven if it is determined that either [Redacted]s are taxable in Idaho, there is no basis for computing Idaho tax liability on a worldwide combined basis.” Letter of protest, p. 4. According to the taxpayer:

[Redacted]and its affiliates are engaged in discrete businesses that are neither dependent upon, nor contributory to, each other. There is little or no overlap of officers and intercompany sales are constitutionally insignificant. The relationship between [Redacted]and its affiliates, especially foreign affiliates, lack centralized management, functional integration and economies of [scale], the hallmarks of a unitary business.

Id.

Idaho Code § 63-3027(t) provides that two or more corporations may be considered a single corporation for income tax purposes, provided more than 50% of the voting stock of each of them is owned directly or indirectly by a common owner or owners, and such treatment is necessary to accurately reflect income. The Idaho Supreme Court has interpreted this statute to require combined reporting by a unitary business. See, e.g., Albertson's, Inc. v. State, Dept. of Revenue, 106 Idaho 810, 683 P.2d 846 (1984). A “unitary business” is a concept of constitutional law under the Commerce and Due Process Clauses of the United States Constitution. A state may tax the multistate income of a nondomiciliary corporation if there is both a “minimal connection” between

the interstate activities and the taxing state and a rational relationship between the income attributed to the taxing state and the in-state value of the corporate business. A state need not attempt to isolate the in-state income producing activities from the rest of the business. The state may tax an apportioned share of the multistate business if the business is unitary. But the state may not tax the business's income that is "derived from unrelated business activity" or a "discrete business enterprise." Allied-Signal, Inc. v. Director, Div. of Tax., 504 U.S. 768, 772-773, 112 S.Ct. 2251, 2255 (1992) (citations and internal quotation marks omitted). See also Albertson's, *supra*, at 815 n.4, 683 P.2d at 851 n.4.

In 1965, Idaho adopted with slight modification the Uniform Division of Income for Tax Purposes Act (UDITPA). Idaho Code § 63-3027. The Act contains a formula for determining the portion of a corporation's total income from a multistate business which is attributable to Idaho and therefore subject to Idaho's income tax. Combined reporting is a refinement of the apportionment principle. Its purpose is to permit application of the UDITPA apportionment formula to a single business enterprise that is conducted by means of separately incorporated entities. In an economic sense, such a business is no different from a similar business composed of a single corporation with several separate divisions. For tax reporting, such businesses should be treated the same. Combined reporting can be required only in the case of a unitary business.

It is well established in Idaho that when the Idaho State Tax Commission has determined that a subsidiary is part of the taxpayer's unitary business, the taxpayer has the burden of proving that the finding is incorrect. Albertson's, *supra*, at 814-815, 683 P.2d at 850 – 851. In the matter currently before this Commission, the MTC audit staff determined that [Redacted]. and all of its more than 50% owned subsidiaries were engaged in a single unitary business during the 1995 through 1997 taxable years. That determination was set out in some detail in the audit report and



was supported by several exhibits. See Audit Report, pp. 6 – 18 and exhibits referenced therein. Thus, the taxpayer must carry the burden of disproving the MTC audit staff's unity findings.

Among the tests of unity is whether “the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state[; if it does], the operations are unitary.” Edison California Stores v. McColgan, 30 Cal. 2d 472, 481, 183 P.2d 16, 21 (1947). See also, Albertson's, *supra* at 815, 683 P.2d at 851 (quoting with approval from Edison California Stores). In applying this test, the MTC audit staff first articulated its understanding of the unitary business principle:

Business operations will be considered unitary when the trade or business activities of each corporation are of mutual benefit, dependent upon, or contributory to the activities of one or more of the corporations. This may be evidenced by facts which establish that the business of the commonly owned group of corporations is functionally integrated or is managed and controlled as a single business enterprise with resulting economies of scale rather than as separate discrete business enterprises carried on by each commonly owned corporation.

Audit Report, p. 7. The audit staff then went on to review and analyze twelve (12) factors that help establish whether the requisite unitary ties exist between each of the members of the [Redacted] group of companies. The factors reviewed by the MTC audit staff were:

- The existence of common officers and directors among the various group members;
- The management structure set up by the parent corporation for reporting and decision making purposes;
- The extent of intercompany sales;
- The extent of intercompany financing activities;
- The extent of any intercompany rents, royalties or license fees;
- The existence of a centralized and commonly operated workforce training program;
- The existence of a centralized and commonly operated computer services function;

- The existence of a centralized insurance function;
- The existence of centralized accounting, purchasing, and advertising;
- The existence of a centralized pension plan;
- The existence of centralized general administrative services; and
- The existence of intercompany personnel services.

In reviewing these twelve factors, the audit staff found that several of the factors either did not indicate a unitary relationship, or that there was insufficient data to assist in making a unity determination. For example, according to the MTC Audit Report the audit staff was provided with insufficient information to determine whether the [Redacted] group of companies offered or made use of a centralized insurance function, a centralized pension plan, or centralized general administrative services. However, in the final analysis the MTC audit staff determined that the data that was made available indicated that [Redacted], and all of its more than 50% owned subsidiaries were engaged in a single unitary business. Among the factors most heavily relied on by the audit staff were: (1) the extent of common officers and directors among the various group members; (2) the extent of intercompany sales as evidenced by the federal consolidated income tax filings for the years under review; (3) the extent of intercompany receivables, intercompany investments, and similar intercompany financing arrangements; (4) the extent of intercompany royalty and license fee payments; and (5) the extent of intercompany payments and commissions relating to personnel services. See Audit Report, pp. 7 – 18.

[Redacted] counters the audit staff's findings by asserting that the evidence is insufficient to establish a unitary business relationship between the various group members. The Tax Commission must respectfully disagree. While there are facts and circumstances in the record that weigh both for and against unity, the overall weight of the evidence supports the audit staff's

determination. More to the point, [Redacted] has not convinced this Commission that the audit staff's determination is incorrect. As a result, the taxpayer has not met its burden of proof. Accordingly, the Tax Commission finds that the taxpayer was engaged in a unitary business in 1995 through 1997, and it was therefore required to compute its Idaho income tax liability on a combined reporting basis.

**C. The Taxpayer has not Established that the MTC Audit Workpapers were in Error.**

The final issue raised in this protest involves what the taxpayer characterizes as miscellaneous errors in the tax deficiency calculations. Specifically, the taxpayer asserts: “[1] The MTC work-papers overstate foreign income by determining foreign income from Form 5471. [2] The workpapers also err in failing to put foreign depreciation on a U.S. basis. [3] The work-papers also understate the foreign factor denominators . . . [and 4] erroneously calculate the sale factor by using gross sales in the numerator and net sales in the denominator.” Letter of protest, p. 4.

The taxpayer has only provided a very cursory description of the miscellaneous computational errors it believes were made by the MTC audit staff. In addition, the taxpayer has not proposed any modifications to the tax deficiency calculations designed to fix these miscellaneous computational errors. The Tax Commission has carefully reviewed the MTC Audit Report and is unable to locate any of the errors referred to in the protest letter. The only error the Commission was able to detect in the MTC workpapers involved the amount of FSC income that was included in the combined net apportionable income of the [Redacted] unitary group. This error was corrected in the August 30, 2002, Notice of Deficiency Determination as indicated on Schedule TC68a, lines 2a and 2b. To the extent there are other computational errors in the MTC audit workpapers, the Tax Commission has been unable to find them.

## CONCLUSION

WHEREFORE, the Modified Notice of Deficiency Determination dated August 30, 2002, is hereby APPROVED, AFFIRMED AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following taxes, penalty, and interest:

<u>PERIOD</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1995	\$12,252	\$3,063	\$7,252	\$22,567
1996	4,715	1,179	2,399	8,293
1997	12,006	3,002	5,062	<u>20,070</u>
TOTAL DUE				<u>\$50,930</u>

Interest is calculated through March 31, 2004, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2004.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that I have on this \_\_\_\_\_ day of \_\_\_\_\_, 2004, served a copy of the within and foregoing DECISION by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

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